

SEATTLE PUBLIC UTILITIES – WATER FUND

FINANCIAL STATEMENTS FOR THE
YEARS ENDED DECEMBER 31, 2001 AND 2000, AND
INDEPENDENT AUDITORS' REPORT

Deloitte & Touche LLP



INDEPENDENT AUDITORS' REPORT

Director
Seattle Public Utilities – Water Fund
Seattle, Washington

We have audited the accompanying balance sheets of the Seattle Public Utilities – Water Fund (the Fund) as of December 31, 2001 and 2000, and the related statements of operations and changes in retained earnings and of cash flows for the years then ended. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on the financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Fund as of December 31, 2001 and 2000, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the financial statements, in 2001, the Fund changed its method of accounting for nonexchange transactions to conform with Governmental Accounting Standards Board (GASB) Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*.

A handwritten signature in black ink that reads "Deloitte & Touche LLP".

March 27, 2002

SEATTLE PUBLIC UTILITIES – WATER FUND

BALANCE SHEETS

DECEMBER 31, 2001 AND 2000

<u>ASSETS</u>	<u>2001</u>	<u>2000</u>
UTILITY PLANT, at original cost:		
Plant in service, excluding land	\$ 823,936,163	\$ 788,616,976
Less accumulated depreciation	<u>(225,141,848)</u>	<u>(205,482,179)</u>
	598,794,315	583,134,797
Construction in progress	170,421,339	134,421,110
Land and land rights	13,511,222	13,477,135
Nonoperating property, net of accumulated depreciation	<u>274,512</u>	<u>408,863</u>
	783,001,388	731,441,905
RESTRICTED ASSETS:		
Construction Fund:		
Cash and equity in pooled investments	1,552,761	50,433,848
Investments	33,578,241	
Vendor deposits – Cash and equity in pooled investments	<u>945,575</u>	<u>1,457,510</u>
	36,076,577	51,891,358
CURRENT ASSETS:		
Cash and equity in pooled investments	1,254,645	8,403,176
Rate Stabilization Fund – Cash and equity in pooled investments	3,000,000	4,252,000
Accounts receivable, net of allowances for doubtful accounts of \$133,756 and \$51,535	9,112,912	8,811,639
Unbilled revenues	5,919,684	4,664,204
Due from other City funds	1,655,192	2,628,142
Due from other governments	778,299	57,751
Materials and supplies inventory	4,508,735	4,745,551
Prepayments and other	11,859	17,235
Current portion of notes and contracts receivable	<u>86,615</u>	<u>27,599</u>
	26,327,941	33,607,297
DEFERRED CHARGES AND OTHER:		
Unamortized bond issue costs, net	4,658,777	4,188,911
Notes and contracts receivable	801,631	145,514
Deferred conservation costs, net	10,897,135	8,618,857
Other deferred charges	<u>24,033,377</u>	<u>16,187,619</u>
	40,390,920	29,140,901
TOTAL	<u>\$ 885,796,826</u>	<u>\$ 846,081,461</u>

See notes to financial statements.

EQUITY AND LIABILITIES20012000

EQUITY:

Retained earnings	\$ 112,436,361	\$ 107,552,368
Contributions in aid of construction	<u>148,640,604</u>	<u>148,640,604</u>
	261,076,965	256,192,972

REVENUE BONDS:

Revenue bonds, due serially	607,490,000	572,560,000
Less revenue bonds due within one year	(18,360,000)	(17,595,000)
Less bond discount and premium, net	(5,144,835)	(6,176,041)
Less deferred charges on advanced refunding	<u>(6,797,877)</u>	<u>(7,450,566)</u>
	577,187,288	541,338,393

NONCURRENT AND OTHER LIABILITIES:

Public works trust loan	1,300,384	1,418,601
Claims payable	1,291,164	2,281,942
Environmental liability	1,300,000	1,970,989
Vendor deposits payable	945,575	1,634,949
Other	<u>711,483</u>	<u>741,910</u>
	5,548,606	8,048,391

CURRENT LIABILITIES:

Accounts payable	6,484,749	5,541,067
Accrued payroll and payroll taxes payable	1,323,540	929,746
Compensated absences payable	3,240,802	2,753,256
Due to other City funds	2,896,446	4,801,555
Claims payable	596,060	620,340
Revenue bonds due within one year	18,360,000	17,595,000
Public works trust loan due within one year	118,217	118,217
Accrued interest payable	8,079,195	7,792,832
Accrued taxes payable	188,898	308,324
Deferred credits and other	<u>696,060</u>	<u>41,368</u>
	41,983,967	40,501,705

TOTAL

\$ 885,796,826\$ 846,081,461

SEATTLE PUBLIC UTILITIES – WATER FUND

STATEMENTS OF OPERATIONS AND CHANGES IN RETAINED EARNINGS YEARS ENDED DECEMBER 31, 2001 AND 2000

	<u>2001</u>	<u>2000</u>
OPERATING REVENUES:		
Direct service	\$ 72,891,449	\$ 71,059,676
Wholesale	30,936,018	33,121,430
Other	<u>1,517,850</u>	<u>1,177,201</u>
Total operating revenues	105,345,317	105,358,307
OPERATING EXPENSES:		
Resource management	18,300,072	16,309,687
Field operations	12,623,509	10,858,697
Engineering services	2,374,650	2,939,935
Customer services	7,701,374	6,526,697
General and administrative	10,736,150	7,691,019
City business and occupation taxes	7,157,162	6,890,171
Other taxes	3,705,544	3,684,761
Depreciation and amortization	<u>23,748,307</u>	<u>18,424,697</u>
Total operating expenses	<u>86,346,768</u>	<u>73,325,664</u>
Net operating income	18,998,549	32,032,643
OTHER INCOME (EXPENSES):		
Investment and interest income	2,206,350	7,106,312
Interest expense	(21,910,147)	(18,291,928)
Amortization of debt expenses	(1,338,285)	(1,400,213)
Gain on sale of capital assets		(1,041,303)
Other, net	<u>1,456,845</u>	<u>1,740,846</u>
Total other expenses	(19,585,237)	(11,886,286)
CAPITAL AND OPERATING FEES, CONTRIBUTIONS, AND GRANTS:		
Capital fees, contributions, and grants	5,186,225	
Operating fees, contributions, and grants	<u>284,456</u>	<u>581,691</u>
Total capital and operating fees, contributions, and grants	<u>5,470,681</u>	<u>581,691</u>
NET INCOME	4,883,993	20,728,048
RETAINED EARNINGS:		
Beginning of year	<u>107,552,368</u>	<u>86,824,320</u>
End of year	<u>\$ 112,436,361</u>	<u>\$ 107,552,368</u>

SEATTLE PUBLIC UTILITIES – WATER FUND

STATEMENTS OF CASH FLOWS

YEARS ENDED DECEMBER 31, 2001 AND 2000

	<u>2001</u>	<u>2000</u>
OPERATING ACTIVITIES:		
Cash received from customers	\$ 103,325,834	\$ 105,071,461
Cash paid to suppliers and employees	(52,956,312)	(48,408,124)
Cash paid for taxes	<u>(10,949,947)</u>	<u>(10,604,553)</u>
Net cash provided by operating activities	39,419,575	46,058,784
NONCAPITAL FINANCING ACTIVITIES:		
Operating grants received	284,456	581,691
CAPITAL AND RELATED FINANCING ACTIVITIES:		
Proceeds from the sale of bonds	53,109,459	
Principal payments on revenue bonds	(17,595,000)	(15,179,999)
Debt issuance costs	(708,715)	
Principal payment on public works trust loan	(118,217)	(118,217)
Acquisition and construction of utility plant and additions to deferred assets	(78,225,637)	(103,504,194)
Interest paid	(29,148,661)	(16,820,204)
Capital fees, contributions and grants	5,186,225	5,183,193
Cash received from disposal of capital assets	<u>1,374,853</u>	<u>2,178,184</u>
Net cash used by capital and related financing activities	(66,125,693)	(128,261,237)
INVESTING ACTIVITIES:		
Purchase of investments	(33,578,241)	
Interest received on investments	<u>2,206,350</u>	<u>6,754,021</u>
Net cash provided (used) by investing activities	<u>(31,371,891)</u>	<u>6,754,021</u>
NET DECREASE IN CASH AND EQUITY IN POOLED INVESTMENTS	(57,793,553)	(74,866,741)
CASH AND EQUITY IN POOLED INVESTMENTS:		
Beginning of year	<u>64,546,534</u>	<u>139,413,275</u>
End of year	<u>\$ 6,752,981</u>	<u>\$ 64,546,534</u>

SEATTLE PUBLIC UTILITIES – WATER FUND

STATEMENTS OF CASH FLOWS *(continued)*
YEARS ENDED DECEMBER 31, 2001 AND 2000

	<u>2001</u>	<u>2000</u>
RECONCILIATION OF NET OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Net operating income	\$ 18,998,549	\$ 32,032,643
Adjustments to reconcile net operating income to net cash provided by operating activities:		
Depreciation and amortization	23,748,307	18,424,697
Cash provided (used) by changes in operating assets and liabilities:		
Accounts receivable	(301,273)	(2,088,662)
Unbilled revenues	(1,255,480)	(927,503)
Due from other City funds	252,402	2,729,319
Materials and supplies inventory	236,816	(32,576)
Current portion of notes and contracts receivable	(59,016)	(2,552)
Prepayments and other	5,376	18,846
Notes and contracts receivable	(656,117)	755,478
Environmental liability	(270,309)	(354,853)
Vendor deposits payable	(689,374)	(159,423)
Accounts payable	943,682	(1,600,831)
Accrued payroll and payroll taxes payable	393,794	(263,055)
Compensated absences payable	487,546	(123,729)
Due to other City funds	(1,905,109)	(2,574,956)
Claims payable	(1,015,058)	305,493
Other liabilities	504,839	(79,552)
Total adjustments	<u>20,421,026</u>	<u>14,026,141</u>
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>\$ 39,419,575</u>	<u>\$ 46,058,784</u>

SEATTLE PUBLIC UTILITIES – WATER FUND

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2001 AND 2000

NOTE 1: OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Operations: The City of Seattle, Seattle Public Utilities – Water Fund (the Fund) is a public utility enterprise fund of the City of Seattle (the City). On January 1, 1997, the City created Seattle Public Utilities (SPU), which brought together under one administrative umbrella the Water, Solid Waste, and Drainage and Wastewater functions of the City as well as certain engineering functions. The Fund (as well as the other funds) remains separate for accounting purposes. SPU receives certain services from other departments and agencies of the City, including some that are normally considered to be general and administrative. The Fund is charged a share of these costs and additionally pays a business and occupation tax to the City's General Fund. Water services provided by the Fund to other City departments and agencies are billed at rates prescribed by City ordinances. Under direction of the Seattle City Council, no charges are made to the City for water services for public fire protection.

SPU provides customer service for, and the cost is shared among, SPU's three utility funds (Water, Drainage and Wastewater, and Solid Waste) and Seattle City Light (SCL). In addition, SPU also performed utility billing for each of these entities until early 2001, when SCL implemented its new billing system, Combined Customer Service System, and began performing the utility billing service for each of the entities. Instead of billing each other for the two operating services, SPU and SCL made an arrangement to exchange the services. For the years ended December 31, 2001 and 2000, the charge to the Fund was \$7,701,374 and \$6,526,697, respectively. The amount shared by SCL for 2001 and 2000 was \$636,514 and \$3,322,062, respectively. SPU received approximately \$2,276,000 of exchanged services in 2001.

The Fund is subject to regulation by the City and the state of Washington. Service rates are authorized by ordinances passed by the City Council. Accounting policies and financial reporting are regulated by the Washington State Auditor's Office, Division of Municipal Corporations and conform to accounting principles generally accepted in the United States of America as applied to governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The Fund has chosen to apply all pronouncements and interpretations issued by the GASB, as well as those issued by the Financial Accounting Standards Board on or before November 30, 1989, except when they conflict with the GASB.

Basis of accounting: The Fund is accounted for on a flow of economic resources measurement focus. Its financial statements are prepared in accordance with accounting principles generally accepted in the United States of America as applied to governmental units using the accrual basis of accounting. With the flow of economic resources measurement focus, all assets and liabilities associated with the Fund's operations are included on the balance sheets. The operating statements present increases (revenues) and decreases (expenses) in total assets.

Revenues: The Fund provides water service to wholesale and retail customers and recognizes revenue when such service is provided. Wholesale customers (Purveyors) are under contract with the Fund and rates are set based on cost allocation criteria stipulated in the contracts.

Service rates for all customers are authorized by ordinances passed by the Seattle City Council. Billings are made to customers monthly or bimonthly. Revenues for water sold to customers between the last billing date and the end of the year are estimated and accrued in the accompanying financial statements.

Utility plant: Utility plant is stated at cost or, if contributed, at fair value at the date of contribution. Costs include direct material, labor, and indirect costs such as engineering, supervision, payroll taxes, pension benefits, and interest relating to the financing of projects under construction. The cost of current repairs and maintenance is charged to expense, while the cost of replacements and betterments is capitalized. At the time property is retired and removed from service, the original cost of the property, together with removal cost less salvage value, is charged to the depreciation reserve.

Depreciation: Plant in service is depreciated on the straight-line method, using composite rates based on estimated lives as follows:

Earthen source of supply developments	100 years
Transmission and distribution reservoirs, tanks, and mains	50 to 100 years
Pumps, wells, and treatment facilities	15 to 33 years
Buildings, fixtures, and equipment	3 to 50 years

It is the Fund's policy to begin recording depreciation in the year following acquisition and to record a full year's charge in the year of disposition.

Construction in progress: Capitalizable costs incurred on projects which are not in use or ready for use are held in construction in progress. When the asset is ready for use, related costs are transferred to utility plant. Upon determining that a project will be abandoned, the related costs are charged to expense.

Deferred conservation costs: Conservation program costs that result in long-term benefits and reduce or postpone other capital expenditures are capitalized and amortized over their expected useful lives of 10 years, commencing when each program is in place. Costs of administering the overall program are expensed as incurred.

Deferred computer systems costs: The Fund capitalizes all direct and incremental costs and the related overhead incurred in connection with the development of significant information systems projects that are to be used internally. Such costs are shown as other deferred charges on the balance sheets and are amortized over the projects' estimated useful life, usually six to eight years. In 2001, the Fund put a computer system, the Consolidated Customer Service System (CCSS), in service. Deferred CCSS costs of \$9,438,452 will be amortized for eight years beginning in 2002.

Preliminary survey investigation costs: The Fund defers costs associated with preliminary survey investigations and feasibility studies within other deferred charges on the balance sheets and amortizes those costs either over the periods for which they are included in rates or over the estimated economic life of the study. In the instance of abandonment of a project, all associated costs would be written off at that time.

Environmental liability cleanup costs: In the ordinary course of conducting its business, the Fund incurs liabilities related to the cleanup of certain environmental contaminants. The Fund's policy is to recognize the expense associated with the cleanup over those periods in which the costs are recovered through rates.

Rate Stabilization Fund: The Rate Stabilization Fund was established in 1993 to reduce future rate spikes. The Fund may deposit a certain amount of proceeds from its revenues into the Rate Stabilization Fund and may withdraw money from the fund and transfer it into any other account in the Fund, at any time. Deposits into the fund are not included as revenue available for debt service coverage in the year the deposit is made. Conversely, money withdrawn from the fund is considered revenue available for debt service coverage in the year the withdrawal is made.

Timber sales: The Fund occasionally contracts with outside timber purchasers to harvest timber owned within its watershed and nonoperating properties. Revenue is recognized based on terms of the harvesting contract. The cutting schedules and associated revenues and expenses are primarily determined by market and other factors. Income arising from timber operations may vary significantly from year to year.

Net revenues from commercial thinning, salvage, and timber harvest in the Cedar River Watershed are obligated, in compliance with City ordinance, to support land and habitat acquisition within the watershed.

Compensated absences: Employees earn vacation based on their date of hire and years in service, and may accumulate earned vacation up to a maximum of 480 hours. Unused vacation at retirement or normal termination is considered vested and payable to the employee. Earned but unused vacation is accrued as a liability of the Fund.

Employees also earn up to 12 days of sick leave per year and may accumulate sick leave balances without limit. Employees are paid 25% of the value of unused sick leave upon retirement. They are not paid for unused sick leave if they leave before retirement. The Fund records a liability for estimated sick leave payments.

Taxes: The Fund is charged a business and occupation tax by the City at a rate of 10% of Fund revenues, net of certain credits. In addition, the Fund paid a public utility tax to the state based on approximately 4% of a certain portion of revenues. The remainder was taxed under the business and occupation tax at the rate of 1.5% in 2001 and 2000.

New accounting pronouncements: In June 1999, the GASB issued Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*, effective for the Fund in fiscal year 2002. For the Fund, this statement will require certain formatting changes to the basic financial statements as well as a required section covering management's discussion and analysis and certain other required supplementary information. The Fund does not anticipate a material impact to the financial position or operations of the Fund as a result of implementing this statement.

Accounting changes: In December 1998, the GASB issued Statement No. 33, which requires the Fund to report nonexchange transactions as revenue. The Fund adopted GASB Statement No. 33 in the year ended December 31, 2001. Capital and operating grants and the donor cost or fair value of contributed property and equipment were reported as a component of equity as contributions in aid of construction prior to implementation of GASB Statement No. 33. In 2001, capital fees, contributions, and grants in the amount of \$5,186,225 are accounted for in the statements of operations and changes in retained earnings as a result of the adoption of the statement. The cumulative effect of the adoption of this standard will be made in 2002 in conjunction with the implementation of GASB Statement No. 34.

Use of estimates: The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect amounts reported in the financial statements. Estimates and assumptions are used to record unbilled revenues, allowance for doubtful accounts, accrued sick leave, environmental liabilities, and other contingencies. Changes in these estimates and assumptions may have a material impact on the financial statements.

Reclassifications: Certain reclassifications have been made to prior year balances to provide a presentation consistent with the current year.

NOTE 2: CASH AND EQUITY IN POOLED INVESTMENTS AND INVESTMENTS

The City's Department of Finance invests all temporary cash surpluses for City departments. This department may, at various times, invest these surpluses in certificates of deposit issued by Washington State depositories that participate in a state insurance pool, U.S. Treasury and agency securities, prime bankers' acceptances trading in the secondary market, and repurchase or reverse-repurchase agreements with primary dealers that use authorized securities as collateral. Delivery of collateral on the underlying securities is required on all repurchase agreement transactions. The Fund is allocated interest income by the City.

It is the City's policy that all investments of the Fund, except repurchase or reverse-repurchase agreements, be held by banks or trust companies as agents of the City and in the City's name. The City's policy is to hold all investments to maturity.

The first \$100,000 of bank deposits are federally insured. The Washington State Public Deposit Protection Commission (PDPC) collateralizes deposits in excess of \$100,000. The PDPC is a multiple financial institution collateral pool. There is no provision for the PDPC to make additional pro rata assessments if needed to cover a loss. Therefore, the PDPC protection is of the nature of collateral, not of insurance.

The City considers highly liquid, short-term investments with original maturities of three months or less to be cash equivalents. The cash pool operates like a demand deposit account in that all agencies, including the City, may deposit cash at any time and can also withdraw cash out of the pool without prior notice or penalty. Accordingly, the statements of cash flows reconcile to cash and equity in pooled investments plus the cash held in escrow for vendors. Securities with maturities exceeding three months at the time of purchase are reported at fair value on the balance sheets; the net increase (decrease) in the fair value of those investments is reported as part of investment income.

Capital expenditures are initially funded by the Operating Fund, which is subsequently reimbursed by the Construction Fund.

Investments are reported at fair values based on quoted market prices for those or similar securities and are as follows at December 31, 2001:

U. S. government securities	\$16,867,846
Commercial paper	<u>16,710,395</u>
	<u>\$33,578,241</u>

NOTE 3: NOTES AND CONTRACTS RECEIVABLE

Other receivables are composed of the following as of December 31:

	<u>2001</u>	<u>2000</u>
Water main assessments	\$ 368,378	\$ —
Land sales receivable	272,453	173,113
Richmond Beach surcharge	<u>247,414</u>	<u> </u>
	888,245	173,113
Less current portion	<u>(86,615)</u>	<u>(27,599)</u>
Total other receivables, net of current portion	<u>\$ 801,630</u>	<u>\$ 145,514</u>

NOTE 4: UTILITY PLANT

Utility plant consists of the following as of December 31:

	<u>2001</u>	<u>2000</u>
Equipment	\$ 713,242,030	\$ 680,576,542
Buildings, fixtures, and grounds	<u>110,694,133</u>	<u>108,040,434</u>
Total plant in service	823,936,163	788,616,976
Less accumulated depreciation	<u>(225,141,848)</u>	<u>(205,482,179)</u>
	598,794,315	583,134,797
Construction in progress	170,421,339	134,421,110
Land	13,511,222	13,477,136
Nonoperating property, net of accumulated depreciation	<u>274,512</u>	<u>408,862</u>
Utility plant, net	<u>\$ 783,001,388</u>	<u>\$ 731,441,905</u>

During 2001 and 2000, the Fund capitalized interest costs relating to construction of \$7,524,877 and \$12,349,027, respectively.

NOTE 5: OTHER DEFERRED CHARGES

Other deferred charges consist of the following as of December 31:

	<u>2001</u>	<u>2000</u>
Capitalized information systems costs	\$50,381,422	\$39,231,119
Environmental liability costs	2,534,432	2,935,111
Intangible assets	1,194,051	1,194,051
Preliminary investigation costs	1,170,476	1,170,476
Less accumulated amortization	<u>(31,247,004)</u>	<u>(28,343,138)</u>
	<u>\$24,033,377</u>	<u>\$16,187,619</u>

NOTE 6: REVENUE BONDS

At December 31, 2000 and 2001, revenue bonds consisted of the following:

	<u>2001</u>	<u>2000</u>
2001 Water System Revenue Bonds, 4.50% to 5.00%, due through 2031, insured by a third-party insurer	\$ 52,525,000	\$ —
1999B Water System Revenue Bonds, 5.00% to 6.00%, due through 2029, insured by a third-party insurer	108,275,000	110,000,000
1999A Water System Revenue Bonds, 4.00% to 5.375%, due through 2029, insured by a third-party insurer	96,785,000	98,420,000
1998 Water System Revenue Bonds, 4.5% to 5.0%, due through 2027, insured by a third-party insurer	75,860,000	77,295,000
1997 Water System Revenue Bonds, 5.375% to 5.625%, due through 2026, insured by a third-party insurer	49,000,000	49,975,000
1995 Water System Revenue Bonds, variable rates averaging 3.3% in 1999, due through 2025, insured by a third-party insurer	42,900,000	44,000,000
1993 Water System Revenue Bonds, 4.7% to 5.5%, due through 2023, insured by a third-party insurer	<u>182,145,000</u>	<u>192,870,000</u>
	<u>\$ 607,490,000</u>	<u>\$ 572,560,000</u>

In November 2001, the Fund issued \$52,525,000 of Water System Revenue Bonds with varying annual and term principal payments due beginning in 2002 and ending in 2031, with annual interest rates ranging from 4.5% to 5.0%.

The Fund defeased certain bonds by placing investments acquired from the proceeds of new bonds in an irrevocable trust to provide for all future debt service payments on the old bonds. Accordingly, the trust accounts and the defeased bonds are not included in the Fund's financial statements. At December 31, 2001, the First Lien Revenue Bonds and Bond Anticipation Notes are considered defeased. The difference between the cost to defease outstanding debt and the carrying value of bonds defeased by refunding bonds is deferred and amortized over the shorter of the remaining term of the refunded bonds or the term of the refunding bonds, using the effective interest method.

Proceeds of the revenue bonds are being used to finance certain capital improvement projects and conservation programs for the Fund.

Future principal and estimated interest payments for revenue bonds are as follows:

<u>Years ending December 31,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2002	\$ 18,360,000	\$ 31,561,045	\$ 49,921,045
2003	19,205,000	30,682,199	49,887,199
2004	20,135,000	29,748,312	49,883,312
2005	17,075,000	28,728,535	45,803,535
2006	16,885,000	27,868,756	44,753,756
Thereafter	<u>515,830,000</u>	<u>342,847,616</u>	<u>858,677,616</u>
	<u>\$ 607,490,000</u>	<u>\$ 491,436,463</u>	<u>\$ 1,098,926,463</u>

Water System Revenue Bonds contain certain financial covenants, the most significant of which requires the Fund to maintain adjusted net revenue to provide for debt service coverage on the bonds and a reserve for the payment of annual debt service. The Fund must maintain adjusted net revenue of not less than 125% of actual annual senior lien debt service. Adjusted net revenues remaining after senior lien debt service has been paid must not be less than 125% of annual junior lien debt service. In 2001, adjusted net revenue was 137% of senior lien debt service, and adjusted net revenue available after senior lien debt service was paid was 708% of junior lien debt service. The Fund has obtained reserve insurance policies to meet its reserve requirements.

Net income	\$ 4,883,993
Add:	
City occupation tax	7,157,162
Depreciation and amortization	23,748,307
Interest on revenue bonds	29,435,024
Amortization of debt expenses and loss	1,338,285
Claims and damages and other expenses not paid in 2001	1,127,853
Noncash investment fair value adjustment	(439,359)
Rate Stabilization Fund	<u>1,252,000</u>
	68,503,265
Less: capitalized interest	<u>7,524,877</u>
Adjusted net revenue available for debt service	<u>\$ 60,978,388</u>
Senior debt service requirement (cash basis)	<u>\$ 44,540,206</u>
Senior lien coverage percentage	<u>137 %</u>
Adjusted net revenue available for junior lien debt service	<u>\$ 16,438,182</u>
Junior lien debt service requirement (cash basis)	<u>2,323,115</u>
Junior lien coverage percentage	<u>708 %</u>

NOTE 7: OTHER LONG-TERM DEBT

During 1993, the Fund entered into an agreement to borrow up to \$2,220,000 from the Washington State Department of Community Development under its Public Works Trust Loan Program for the construction of certain capital improvements. As of December 31, 2001 and 2000, the Fund owed \$1,418,601 and

\$1,536,817, respectively. Amounts borrowed under the agreement accrue interest at 1% per annum and are to be repaid in 19 equal annual installments, plus interest.

NOTE 8: ENVIRONMENTAL LIABILITY

The Fund has recorded an estimated \$1,300,000 liability for future environmental cleanup costs related to lead-based paint and arsenic contamination surrounding several standing water tanks as well as expected remediation efforts associated with underground fuel tank replacements. The liability is included in other long-term liabilities on the balance sheet. The total cost is expected to be recovered through rates over an estimated 30-year period.

The schedule below represents the changes in the estimated liability:

	<u>2001</u>	<u>2000</u>
Beginning liability	\$ 1,970,989	\$ 2,325,842
Payments	<u>(670,989)</u>	<u>(354,853)</u>
Ending liability	<u>\$ 1,300,000</u>	<u>\$ 1,970,989</u>

NOTE 9: RETIREMENT PLANS

Pension costs: All permanent Fund employees are eligible to participate in the Seattle City Employees' Retirement System (the System), a cost-sharing public employee retirement system operated by the City. Benefits vest after five years of covered service. City employees may retire after 30 years of service regardless of age; after age 52, with 20 or more years of service; after age 57, with 10 or more years of service; and after age 62, with five or more years of service. The System also provides death and disability benefits. These benefit provisions and all other requirements are established by City ordinances. The System's financial report that includes financial statements and required supplementary information for the System is available through the City.

City employees are required to contribute 8.03% of their annual base salary to the System. The City's contribution rate was 8.03% as of January 1, 2001 and 2000. Employer rates are established by the City Council on a biannual basis. The Fund's contributions to the System for the years ended December 31, 2001, 2000, and 1999, were \$2,461,551, \$2,357,781, and \$2,430,912, respectively. The Fund's contribution in 2001 represents its full liability to the System.

The System issues stand-alone financial statements which may be obtained by writing to the Seattle City Employees' Retirement System, 801 Third Avenue, Suite 300, Seattle, Washington, 98104; telephone: (206) 386-1292.

Employer contributions for the City are as follows (dollars in millions):

<u>Year ended December 31,</u>	<u>City required contribution</u>	<u>City actual contribution</u>	<u>Percentage contributed</u>
1999	\$ 29.7	\$ 29.7	100 %
2000	30.8	30.8	100
2001	32.5	32.5	100

Actuarial data and assumptions

Valuation date	January 1, 2001
Actuarial cost method	Entry age
Amortization method	Level percent
Remaining amortization period	-0- years
Amortization period	Open
Asset valuation method	Market
Investment rate of return	8.00%
Projected general wage inflation	4.50%
Postretirement benefit increases	0.67%

Schedule of funding progress (dollars in millions):

<u>Actuarial valuation date</u>	<u>Actuarial value of assets (a)</u>	<u>Actuarial accrued liabilities (AAL) – entry age ⁽¹⁾ (b)</u>	<u>Unfunded AAL (UAAL) ⁽²⁾ (b-a)</u>	<u>Funded ratio (a/b)</u>	<u>Covered payroll ⁽³⁾ (c)</u>	<u>UAAL as a percentage of covered payroll ((b-a)/ c)</u>
1/1/1999	\$ 1,375.0	\$ 1,326.6	\$ (48.4)	103.6 %	\$ 370.4	(13.1)%
1/1/2000	1,582.7	1,403.1	(179.6)	112.8	370.4	(48.5)
1/1/2001	1,493.1	1,490.3	(2.8)	100.2	383.7	(.7)

- (1) Actuarial present value of benefits less actuarial present value of future normal costs based on entry age actuarial cost method.
- (2) Actuarial accrued liabilities less actuarial value of assets.
- (3) Covered payroll includes compensation paid to all active employees on which contributions are calculated.

Deferred compensation: The City offers all of its employees a deferred compensation plan (the Plan) created in accordance with Internal Revenue Code (IRC) Section 457. The Plan permits employees to defer a portion of their salary until future years. The deferred compensation is paid to employees upon termination, retirement, death or unforeseen emergency.

Effective January 1, 1999, the Plan is an eligible deferred compensation plan under Section 457 of the IRC of 1986, as amended, and a trust exempt from tax under IRC Sections 457(g) and 501(a). The Plan is operated for the exclusive benefit of participants and their beneficiaries. No part of the corpus or income of the Trust shall revert to the City or be used for, or diverted to, purposes other than the exclusive benefit of participants and their beneficiaries.

The Plan is not reported in the financial statements of the City or the Fund.

It is the opinion of the City's legal counsel that the City has no liability for investment losses under the Plan. Under the Plan, participants select investments from alternatives offered by the Plan Administrator, who is under contract with the City to manage the Plan. Investment selection by a participant may be changed from time to time. The City does not manage any of the investment selections. By making the selection, participants accept and assume all risks inherent in the Plan and its administration.

NOTE 10: RISK FINANCING LIABILITIES

The City and the Fund are self-insured for certain losses arising from personal and property damage claims by third parties and for casualty losses to the Fund's property. Liabilities for identified claims and claims incurred but not reported have been recorded by the Fund.

For 2001 and 2000, liabilities for workers' compensation claims as well as other claims are discounted over a 15-year period at the City's rate of return on investments, 5.34% and 6.17%, respectively. Claims expected to be paid within one year were \$596,060 and \$620,340 at December 31, 2001 and 2000, respectively. The schedule below represents the changes in the liability for workers' compensation claims and other claims (risk-financing liabilities) as of December 31:

	<u>2001</u>	<u>2000</u>
Beginning liability	\$2,902,282	\$2,596,789
Payments	(2,142,911)	(631,191)
Incurred claims and changes in estimates	<u>1,127,853</u>	<u>936,684</u>
Ending liability	<u>\$1,887,224</u>	<u>\$2,902,282</u>

NOTE 11: COMMITMENTS AND CONTINGENCIES

Seattle Public Utilities has prepared a comprehensive environmental management plan for its Cedar River Watershed. The purpose of the Habitat Conservation Plan (HCP) is to protect all species of concern that may be affected by the operations of Seattle Public Utilities and City Light in the Cedar River Watershed, while allowing the City to continue to provide high quality drinking water to the region. The federal government has accepted the HCP. Expenditures are expected to be funded from a combination of operating revenues and debt.

The Fund has negotiated an agreement relating to compliance with the Surface Water Treatment Rule on its Cedar River supply system, which requires it to evaluate ozonation and filtration, and recommend changes to current treatment. A recommendation for ozonation compatible with filtration was provided to the Washington State Department of Health in November 1995, and approved in January 1996. The cost for an ozonation facility is estimated at \$80,000,000 to \$100,000,000, depending on facility size and treatment technology. It is anticipated that these estimated capital expenditures will be funded over the next decade, primarily through water revenue bonds. The current schedule would make this facility operational by 2004.